

NATIONAL GRAIN TRADE COUNCIL

SUITE 925
1300 L STREET, N.W.
WASHINGTON, D.C. 20005

(202) 842-0400

February 23, 1998

Ms. Jean A. Webb
Secretariat
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, DC 20581

Dear Ms. Webb:

The National Grain Trade Council is writing to comment on the proposed rulemaking the Commission published in the January 23, 1998, *Federal Register* entitled "Voting by Interested Members of Self-Regulatory Organization Governing Boards and Committees."

The Council is a national trade association whose voting members are grain exchanges and boards of trade. The Council's associate members are grain companies and related businesses.

The Proposed Rule

The proposed rule would implement provisions of law enacted by Congress in the Futures Trading Practices Act of 1992 to preclude conflicts of interest by governing members of exchanges when an exchange must take action to address extraordinary market situations.

To be more precise, the proposed rule would require futures self-regulatory organizations (including exchanges, clearing corporations, and industry groups like the National Futures Association) to adopt rules prohibiting governing board, disciplinary committee, and oversight panel members from deliberating or voting on certain matters where the member had either a *family relationship* with the matter's named party in interest or a *financial interest* in the matter's outcome.

The proposed rules would apply when exchange boards or committees are considering "significant actions," such as market emergencies or changing margin levels in response to extraordinary market conditions. These extraordinary conditions would include events such as an attempted corner, squeeze, congestion, or undue concentration of positions or that otherwise are likely to have a substantial effect on prices in any contract traded or cleared at the self-regulatory organization (SRO).

The Commission's proposed rule would require each SRO to establish procedures for determining whether any member of its governing board, disciplinary committees, or oversight

98-4
①
COMMODITY FUTURES
TRADING COMMISSION
RECEIVED

FEB 25 1 07 PM '98

COMMENT

COMMODITY FUTURES
TRADING COMMISSION
RECEIVED FOR
PUBLIC RECORD
FEB 26 12 38 PM '98

committees is subject to a conflict of interest. The determination would be based on information provided by the member and any other source of information that is reasonably available to the SRO.

NGTC Views

The National Grain Trade Council supports prudent steps to guard against conflicts of interest. Self-regulation does bring special responsibilities and burdens to assure the public that decisions are made in a fair, equitable, and objective fashion. This innate need for integrity and fairness, though, is just as important to market participants and exchange members as it is to the public.

With that motivation, we believe exchanges have done a good job of ensuring market integrity and guarding against conflicts of interest. The types of situations envisioned by the CFTC proposal come before an exchange board only rarely. They may come before an exchange disciplinary or oversight committee more often. An exchange's business conduct committee, for example, routinely monitors the expiration of a contract to ensure an orderly liquidation. In carrying out those responsibilities, there will be times when committee members are made aware of positions carried by parties in the expiring contract. In that situation, the committee will ask members to recuse themselves if they knowingly own or control positions that would be affected by the matter at hand.

This procedure already guards against the clear cut situation where common sense tells us a committee member representing a firm that owns 85 percent of the open interest in an expiring contract, for example, should not be sitting in judgment of how the exchange deals with this situation.

It is only rarely that these issues are not resolved before they reach an exchange board, which represents the highest decision-making level within the self-regulatory system. The own-or-control standard is typically used in board settings to guard against conflicts of interest. When an issue does reach this level, it is usually a high profile matter requiring quick action. These types of issues may come before the board of a large exchange with a variety of contracts, perhaps once every five years. They may come before the board of a small exchange once every 20 years.

The Commission's proposed rule would require exchanges -- large and small -- to develop an elaborate procedure for determining if conflicts of interest are present. To preclude a potential conflict of interest, the SRO would be required to review positions held by the member, the member's family, the member's firm, and the customers of the member's firm in any contract that could be affected by the Committee action. Clearing relationships introduce yet another level of complexity.

Our concern is that the resulting rules could preclude anyone with a market position from participating in exchange decisions at several levels. We worry that the Commission's proposal would result in the exclusion of at least three categories of key participants: (1) floor traders who are active in a given market; (2) representatives of a grain company with significant positions in the cash and futures market; and (3) representatives of futures commission merchants with a broad customer base who typically have positions in a given market.

These exclusions could pose a real threat to exchange self-governance. For a smaller exchange, easily 70 to 80 percent of an exchange board or committee would fall into one of the three categories listed above and would be excluded. Even a larger exchange could see its board reduced by 25 percent and a specific committee by 50 percent in such circumstances.

The proposed rule sets up a worst case scenario for a small exchange where it is confronted by a high-profile market emergency in its primary contract and 80 percent of its board is precluded from participating in the decision on how to address the matter. It could freeze decision-making at a critical juncture for smaller exchanges.

In Summary

Therefore, while the National Grain Trade Council supports steps to guard against conflicts of interest, we cannot support the rule as proposed. We believe the proposed rule would: (1) impose unreasonably burdensome regulations on exchanges; (2) deprive exchanges of key expertise at critical junctures; and (3) preclude most active market participants from serving on key exchange committees.

Respectfully,



Robert R. Petersen
President